

REPORT BY THE

CONTROLLER'S AUDITS DIVISION

CITY AND COUNTY OF SAN FRANCISCO

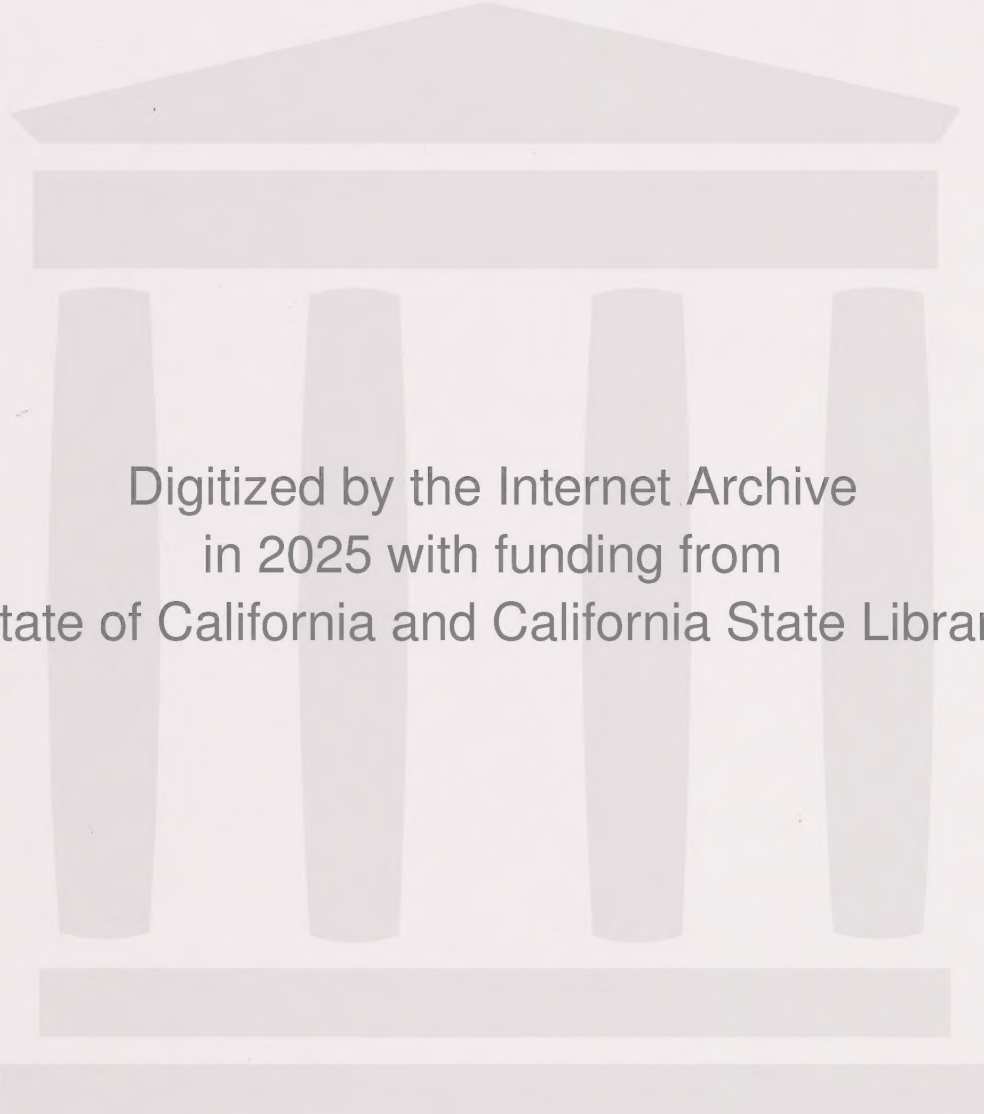
A Review of Pacific Gas and Electric Company's Franchise Payments



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February 17, 1995

Board of Supervisors
City and County of San Francisco
City Hall, Room 200
San Francisco, CA 94102

President and Members:

The Controller's Audits Division presents its report on the review of franchise payments Pacific Gas and Electric Company (PG&E) made to the City and County of San Francisco (City) to use its streets to transmit, distribute, and supply electricity, gas, and steam within the City. PG&E is required to report its gross receipts and pay each year a total of one-half percent of its gross receipts on the sales of electricity, one percent of its gross receipts on the sales of gas, and two percent on the portion of steam sales subject to the franchise fee.

Reporting Period: January 1, 1991 through December 31, 1993

Franchise Fees Paid:	Electricity	\$7,154,625
	Gas	4,594,724
	Steam	<u>160,364</u>
	Total	\$11,909,713

Results:

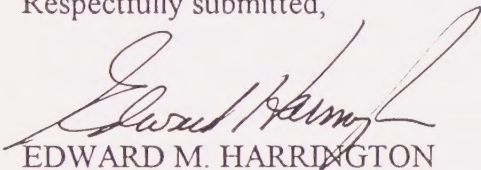
- PG&E reported its electric, gas, and steam receipts to the City and correctly paid its franchise fees based on its reported receipts on a timely basis. PG&E properly reported the portions of electric sales to the City's Hetch Hetchy Water and Power that were subject to the franchise fees.
- We believe PG&E owes the City franchise fees for using City streets to deliver electricity and gas to the Presidio. PG&E does not include the sales it makes to the Presidio in the gross receipts that are subject to the City's franchise fees. PG&E does not believe these revenues should be subject to the City's franchise fees because a City Attorney opinion issued in September 1941 indicated that the franchise agreements were drawn with the intention of excluding the Presidio. However, a subsequent City Attorney opinion issued in December 1941 also indicated that PG&E did not have any rights to use the City streets to make the deliveries to the Presidio.

Using the same rates required in the franchise agreements, we estimate that PG&E should pay additional franchise fees of \$114,276 for using City streets to deliver electricity and gas to the Presidio for the period from January 1, 1991 through December 31, 1993.

- PG&E did not provide sufficient documents for us to conclude on the reasonableness of some of its reported receipts and deductions from receipts. PG&E did not provide us sufficient information for us to determine whether its deductions of \$6,445,120 from gross receipts for uncollectible accounts were reasonable. In addition, PG&E did not resolve some of the discrepancies we identified when we recomputed some customer billings to determine the reasonableness of the gross receipts PG&E reports as subject to the City's franchise fees.

The Pacific Gas and Electric Company's response is attached to this report.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Edward M. Harrington", is written over the printed name.

EDWARD M. HARRINGTON
Controller

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Introduction

In 1939, the City and County of San Francisco (City) granted Pacific Gas and Electric Company (PG&E) and its successors two franchises to use City streets to transmit, distribute, and supply electricity and gas. In consideration for the two franchises, PG&E agreed to pay the City a one-time sum of \$400,000 and annually pay a percentage of its gross receipts from the sales of electricity and gas in the City. In 1975, the City granted PG&E and its successors a franchise to use City streets to install, maintain, and operate underground steam pipes for heating and all other purposes within the City, and agreed to pay the City annually a percentage of its gross receipts from the sale of steam in the City.

The franchise agreements require PG&E to remit, by April 15 of each year, a total of one-half percent of its gross receipts on the sales of electricity, one percent of its gross receipts on the sales of gas, and two percent of its gross receipts on the sales of steam from the previous year. In reporting the gross receipts subject to the City's franchise fees, PG&E deducts from its total receipts such amounts as uncollectible accounts, revenues from the Presidio of San Francisco (Presidio), and interdepartmental sales, including cost of supplying electricity and gas to buildings and other properties owned by PG&E. According to the franchise agreements, the City has the right to ascertain and check the amounts due the City.

Scope and Methodology

The purpose of this audit was to determine whether PG&E correctly reported its gross receipts and paid the City the correct franchise fees under the terms of the franchise agreements for the period from January 1, 1991 through December 31, 1993. To conduct the audit, we reviewed the applicable provisions of the franchise agreements. We interviewed staff from PG&E, the City Attorney's Office, and Hetch Hetchy Water and Power.

To determine whether PG&E correctly reported its annual gross receipts, we tested the amounts PG&E reported to the City to the amounts PG&E recorded in its monthly summary reports and monthly detailed reports. We examined, on a test basis, the accuracy of PG&E's customer billings by recomputing the amounts billed using the rate schedules approved by the California Public Utilities Commission. We also tested, on sample basis, the reasonableness of some of PG&E's deductions from total receipts, including uncollectible accounts, revenues derived from the sales of electricity and gas to the Presidio, and electricity and gas usage by PG&E's departments and offices.

Scope Limitations

We were unable to complete some of our tests because PG&E did not provide us access to all the information we needed to complete our tests. PG&E did not provide sufficient detailed information on the uncollectible accounts for us to conclude whether the amounts PG&E was deducting were reasonable. In addition, PG&E did not provide the information we needed to complete our analysis of customer billings. Out of the 315 customer bills we tested, we could not verify the accuracy of 29 (9.2 percent) of the customer bills. As a result, we could not conclude on the reasonableness of PG&E's customer billings for the period from January 1, 1991 through December 31, 1993.

Audit Results

PG&E Reported Its Receipts and Paid Its Franchise Fees on a Timely Basis

For the period from January 1, 1991 through December 31, 1993, PG&E reported \$1,898,415,771 in electric, gas, and steam sales within the City, and correctly paid \$11,909,713 in franchise fees based on its reported receipts on a timely basis. Table 1 shows the gross receipts and franchise fees paid to the City from January 1, 1991 through December 31, 1993.

Table 1
Pacific Gas and Electric Company
Reported Gross Receipts and Franchise Fees Paid
January 1, 1991 through December 31, 1993

	<i>Receipts</i>		<i>Franchise Fees</i> <i>(Note 1)</i>
Electric	1991	\$463,168,891	\$2,315,844
	1992	477,103,672	2,385,518
	1993	<u>490,652,672</u>	<u>2,453,263</u>
	Subtotal	\$1,430,925,235	\$7,154,625
Gas	1991	\$167,204,282	\$1,672,043
	1992	146,651,953	1,466,520
	1993	<u>145,616,120</u>	<u>1,456,161</u>
	Subtotal	\$459,472,355	\$4,594,724
Steam	1991	\$3,146,988	\$62,940
	1992	3,142,966	62,859
	1993	<u>1,728,227</u>	<u>34,565</u>
	Subtotal	\$8,018,181	\$160,364
Total		\$1,898,415,771	\$11,909,713

Note 1: Franchise fee rates are one-half percent of electric receipts, one percent of gas receipts, and two percent of steam receipts.

Hetch Hetchy Electricity Sales

The gross receipts from the sale of electricity include sales made to the City's Hetch Hetchy Water and Power (Hetch Hetchy). PG&E has an agreement with Hetch Hetchy to transmit electricity inside and outside the City, distribute electricity within the City, and sell supplemental power to the City. PG&E bills Hetch Hetchy for the electricity sales, as well as for transmission and distribution

charges, supplemental power charges, demand charges, and other special charges. We reviewed the Hetch Hetchy billings to ensure that PG&E properly reported the portions of the electricity sales that are subject to the franchise fee.

For the three years we reviewed, PG&E billed Hetch Hetchy over \$76 million for services, identified \$27 million (36 percent) of the total as subject to the City's franchise fees, and paid the City one-half percent of this amount, or \$135,832. Based on our tests, we are reasonably assured that PG&E properly identified the portions of the total Hetch Hetchy bill that were subject to the franchise fee, and correctly paid the City the fees it was due.

**PG&E May Owe the City Franchise
Fees for Using City Streets to Deliver
Electricity and Gas to the Presidio**

For the period from January 1, 1991 through December 31, 1993, PG&E deducted \$16,750,966 in electricity and gas revenues received from the Presidio from the gross receipts reported to the City as subject to the City's franchise fees. According to a PG&E supervisor in the revenue and reporting section, PG&E has historically not included sales in the Presidio when calculating the sales subject to the City's franchise fees. This practice was based on PG&E's interpretation of a City Attorney's opinion dated September 2, 1941. This opinion states that the City's franchise agreements did not specifically include the Presidio and were drawn with the intention of excluding the Presidio. PG&E therefore concluded that any revenues from electricity and gas sales to the Presidio should not be subject to the City's franchise fees. Furthermore, PG&E cited United States Supreme Court decisions which state that land used for military purposes are under the jurisdiction of the government of the United States, and not under the jurisdiction of the states. PG&E concluded that San Francisco had no jurisdiction over sales to the Presidio, and was not entitled to any franchise fees for sales in the Presidio.

However, to make the sales in the Presidio, PG&E uses the City's streets to deliver the electricity and gas. We believe the City has the right to be paid for the use of its streets to deliver the electricity and gas to the Presidio. This issue was addressed in a subsequent City Attorney opinion dated December 29, 1941, which stated that nothing in the franchise agreements gave PG&E the rights to maintain gas pipes and electric wires in city streets for distribution of gas and electricity in military reservations.

Using the same rates as required in the franchise agreements, we estimate that PG&E should pay additional franchise fees of \$114,276 for using City streets to deliver electricity and gas to the Presidio for the period from January 1, 1991 through December 31, 1993. Because PG&E's annual report of gross receipts does not itemize deductions for the Presidio sales, we did not have the necessary information to estimate franchise fees due to the City for the periods before January 1, 1991.

Recommendation

To ensure that the City receives all franchise fees it is due, the City, through its City Attorney and Controller, should take the following action:

- Collect the franchise fees from PG&E for using City streets in past years when it delivered electricity and gas to the Presidio and ensure that such fees are paid in future years.

**PG&E Did Not Provide Sufficient
Documents Supporting the
Reasonableness of Its Reported Gross Receipts**

To determine the reasonableness of PG&E's reported gross receipts, we conducted tests of PG&E's receipts and deductions from the receipts. However, we were unable to complete our tests because PG&E could not or did not provide us sufficient documents to complete our tests. We conducted a test of the deductions PG&E made for uncollectible accounts. For the three years we reviewed, PG&E deducted \$6,445,120 in uncollectible accounts from its gross receipts reported to the City as subject to the City's franchise fees. However, PG&E would not allow us to examine detailed supporting records of individual uncollectible accounts. In addition, PG&E did not resolve all the discrepancies we identified when we recomputed billing amounts for a sample of customer billings to determine the reasonableness of the receipts PG&E reported as subject to the franchise fees. Because PG&E did not provide us all the information we needed to complete our tests, we could not conclude on the reasonableness of the amounts PG&E reported as gross receipts, nor that it correctly paid the City all the franchise fees it was due.

***PG&E Did Not Provide Sufficient
Information to Support Its Deductions
For Uncollectible Accounts***

For the period from January 1, 1991 through December 31, 1993, PG&E deducted \$6,445,120 as uncollectible accounts from the revenues subject to the franchise fees. To assess the reasonableness of these deductions, we reviewed the amounts reported by PG&E as uncollectible in 3 sample months during the audit period. However, we were unable to complete our test because PG&E did not provide the detailed information necessary for us to assess the reasonableness of the amounts reported as uncollectible. According to a PG&E supervisor in the revenue and control section, PG&E has a report that lists individual uncollectible accounts in San Francisco from which the total amounts are calculated, but could not allow us to review this report because it also contained individual uncollectible accounts from two other locations, specifically Daly City and San Bruno. As a result, we could not determine if the amounts identified as uncollectible by PG&E were reasonable.

***PG&E Did Not Provide Sufficient Information
On the Reasonableness of Customer Billings***

To assess the reasonableness of PG&E's reported gross receipts, and the resulting franchise fees, we examined randomly selected samples of customer billings prepared by PG&E from the period January 1, 1991 through December 31, 1993. We tested 136 electricity bills, 119 gas bills, and 60 steam bills to determine whether PG&E correctly billed its customers for the services provided, and paid the City the appropriate franchise fees. Based on the information provided to us by PG&E, we recomputed customer bills using the rates approved by the California Public Utilities Commission for the periods we tested. Table 2 shows the number of customer bills tested, the total amount of those bills, the amounts we recomputed, and the discrepancies between our recomputed amounts and PG&E's billings. For the 3 months we reviewed, we found several discrepancies between PG&E's billings and our recomputations. The major differences were in electric billings for November 1991, where our recomputation resulted in a total billing \$514,130 less than the amount billed by PG&E, and in steam billings for November 1991, where our recomputation resulted in a total billing \$22,909 more than the amount billed by PG&E. (See Appendix A for the details of the November 1991 electric billings.)

We asked PG&E to resolve the discrepancies. Although PG&E's staff assisted us in resolving some of the customer billing discrepancies we identified, PG&E did not assist us in resolving others. PG&E's Controller stated that PG&E did not want to continue to spend more time confirming the accuracy of those billings with unresolved discrepancies because the City does not have a business interest in this area. According to him, the electric and gas franchise agreements only entitle the City to a franchise fee payment based on the amount the customer was billed and the amount PG&E received. Further, according to PG&E's Controller, if the billings were in error, and PG&E did not receive all that it was due, then the City has not lost any revenues since PG&E did not receive those amounts and would not be liable for the franchise fee. Furthermore, PG&E's Controller stated that PG&E's counsel believes that PG&E has no legal obligation to assist us in confirming the accuracy of the customers billings under the franchise agreements.

Table 2
Pacific Gas and Electric Company
Summary of Customer Billings Review
January 1, 1991 through December 31, 1993

	<i>Number of Bills Tested</i>	<i>Billed Amount</i>	<i>Recomputed Amount</i>	<i>Number of Bills Unresolved</i>	<i>Amount of Discrepancies Over(Under)</i>
Electric					
November 1991	46	\$837,865	\$323,735	21	(\$514,130)
July 1992	46	1,107,159	1,107,159	0	0
December 1993	<u>44</u>	<u>2,813</u>	<u>2,813</u>	<u>0</u>	<u>0</u>
Subtotal	136	\$1,947,837	\$1,433,707	21	(\$514,130)
Gas					
November 1991	45	\$6,822	\$6,822	0	0
July 1992	41	6,867	7,540	5	673
December 1993	<u>33</u>	<u>1,359</u>	<u>1,359</u>	<u>0</u>	<u>0</u>
Subtotal	119	\$15,048	\$15,721	5	673
Steam					
November 1991	20	\$83,810	\$106,719	3	\$22,909
July 1992	20	93,364	93,364	0	0
January 1993	<u>20</u>	<u>141,216</u>	<u>141,216</u>	<u>0</u>	<u>0</u>
Subtotal	60	\$318,390	\$341,299	3	\$22,909
Total	315	\$2,281,275	\$1,790,727	29	(\$490,548)

We disagree, however, and believe the City has the right to confirm whether PG&E is correctly billing its customers and paying the correct franchise fees. If PG&E is not collecting all the amounts it is due, then the City is not receiving all the franchise fees it is due. Similarly, if PG&E is overcharging its customers, then the City is receiving more in franchise fees than it is due. In addition, we are also concerned whether PG&E may be giving discounts to certain customers, for example, in return for services from those customers. However, PG&E's Controller assured us that the California Public Utilities Commission does not allow a utility to give discounts in return for services.

Although PG&E's Controller indicated he would have his staff investigate the discrepancies we identified, PG&E has not provided us the results of its investigation. Because PG&E refused to assist us in resolving all the discrepancies we identified, we cannot fully determine if PG&E correctly billed its customers for the period reviewed, and paid the correct franchise fees based on those billings.

Recommendations

To ensure that the City receives all the franchise fees it is due, the City, through its City Attorney and Controller, should take the following actions:

- Require PG&E to maintain adequate and sufficient records to support its allocation of revenues subject to franchise fee calculations; and
- Require PG&E to allow the City access to all its records for audit.

We conducted this review according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



NORIAKI HIRASUNA
Director

Date: February 17, 1995

Staff: Elena Chiong, Audit Manager
Gani Soy

Appendix A

**Pacific Gas & Electric Company
Summary of Customer Billings Review by Type of Customer
November 1991**

Report by the Controller's Audits Division
Pacific Gas and Electric Company's Franchise Payments
February 17, 1995

Appendix A

Pacific Gas and Electric Company
Summary of Customer Billings Review by Type of Customer
November 1991

Type of Customer	Number of Bills Tested	Billed Amount	Recomputed Amount	Number of Bills Unresolved	Amount of Discrepancies Over(Under)
Residential Service	12	\$418	\$418		\$0
Residential-Low Income Service	1	44	44		0
Master-Metered Multifamily Service	2	538	538		0
Small-General Service	10	3,912	3,912		0
Medium-General Demand- Metered Service	8	19,686	21,926	8	2,240
Medium-General Demand- Metered Time-of- Use Service	1	2,531	2,767	1	236
Commercial/Industrial-Primary	1	59,416	41,709	1	(17,707)
Commercial/Industrial-Secondary	11	751,320	252,421	11	(498,899)
Total	46	\$837,865	\$323,735	21	(\$514,130)

Response to the Audit

Pacific Gas and Electric Company

*Report by the Controller's Audits Division
Pacific Gas and Electric Company's Franchise Payments
February 17, 1995*

Pacific Gas and Electric Company

77 Beale Street
Mail Code B11C
P.O. Box 770000
San Francisco, CA 94177
415/973 2691
Fax 415/973-1525

Thomas G. Long
Controller

February 16, 1995



Mr. Edward M. Harrington
Controller
City and County of San Francisco
City Hall
San Francisco CA 94102

Dear Mr. Harrington:

Thank you for the opportunity to respond to your staff's audit report scheduled to be issued February 17, 1995. Listed below is PG&E's response to your audit staff's recommendations:

Recommendation:

"To ensure that the City receives all franchise fees it is due, the City through its City Attorney and Controller should take the following action: Collect the franchise fees from PG&E for using City streets in past years when it delivered electricity and gas to the Presidio and ensure that fees are paid in future years."

Response:

Both gas and electric franchises granted to PG&E authorize the Company "to introduce into, transmit, distribute and supply to the City and County of San Francisco and its inhabitants gas and electricity for every use and purpose" (Sec 2 of franchises). The franchises require PG&E to pay fees based on gross receipts from sales "within the limits of the city" (Section 4 of franchises). The Presidio is clearly within the geographical limits and boundaries of the City and County of San Francisco (S.F. Charter Sec. 1.100, Government Code section 23138). The utilization of city streets to provide gas and electric services to a military installation within the boundaries of the City is merely a use incidental to the rights and authority granted by the franchises. The Company's use of city streets to serve the Presidio is a practice which the Company has conducted with the full knowledge and acceptance of the City and County for over one half of a century.

The City and County has not required PG&E to pay franchise fees on receipts from sales within the Presidio because of a 1897 statute ceding the authority to require such exactions to the Federal Government.

Mr. Edward Harrington
February 16, 1995
Page 2



Recommendation:

"Require PG&E to maintain adequate and sufficient records to support its allocation of revenues subject to franchise fee calculations and require PG&E to allow the City access to all its records for audit."

Response:

PG&E does maintain adequate records to support the franchise calculation and PG&E did allow the City access to all its records that were relevant to the review.

Customer Bills:

PG&E paid the correct franchise fees due the City for fees based on gross annual receipts and the auditors agreed (Page 3 of Audit Results). However, the auditors would also like to know if we billed customers correctly pursuant to the rates approved by the California Public Utilities Commission (CPUC).

As important as accurate billings are to our customers, the Company, and to the CPUC, it is simply not a relevant issue to the review. That is, the fee due is based on "gross annual receipts".

In any event, all the "records" necessary to confirm the billings were made available to the auditors. Additionally, our external auditors (Arthur Anderson and Co.) explained to your staff the various independent revenue tests conducted quarterly and annually to support the correct application of CPUC approved rates.

*1

Uncollectibles

All available and applicable reports in support of the total uncollectible amount for the City of San Francisco were provided to the audit team.

The ratio of uncollectible accounts to total billed revenues for the City and County of San Francisco for the 3 year audit period in question represents less than one half of a percent. This is consistent with company wide ratios.

2

* The Controller's Audits Division's comments on specific points contained in this response appears on page 21.

*Report by the Controller's Audits Division
Pacific Gas and Electric Company's Franchise Payments
February 17, 1995*

Mr. Edward Harrington
February 16, 1995
Page 3



Additionally PG&E provided detailed explanations of the reports, a flowchart of various processes within the Customer Information System, and written policies and procedures on uncollectible accounts. An offer to randomly select any account in San Francisco to determine the application of such policy was declined by the audit team.

If you have any questions, please do not hesitate to call me at (415) 973-2691.

Sincerely,

A handwritten signature in cursive script, reading "Thomas C. Long", is positioned above the printed name.

Thomas C. Long

**Controller's Audits Division's Comments
on the Response of Pacific Gas and Electric Company**

1. In some of our initial tests of customer billings, we identified a number of discrepancies when we recomputed billing amounts for San Francisco accounts. The staff of PG&E resolved these initial discrepancies by providing us information not initially given to us. As we continued with our testing, PG&E stopped cooperating and refused to resolve other discrepancies. These are the discrepancies we identify in our report. If PG&E is correct in asserting that it has provided us all the records necessary to confirm the billings, we do not understand why our recomputations should differ from the amounts billed by PG&E, and why PG&E would not resolve them with us.
2. While PG&E is correct in asserting that it gave us a report in support of the total uncollectible amount, PG&E did not provide us any reports which we could test to verify that the individual accounts contributing to the total were only San Francisco accounts. The report PG&E provided us showed only the total uncollectible amount for each month. When we asked to review the report which listed the individual accounts that contributed to the monthly total, a PG&E staff person said we could not review that report because it contained accounts from other cities. The application of PG&E's write-off policy was not at issue, and PG&E's offer to select a San Francisco account to test that policy was not related to the tests we needed to conduct. Our concern was whether PG&E was accurately reporting only uncollectible accounts from San Francisco.



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